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"Murky Protectionism" in Europe: How Should Binding Rules Be Evaluated in Tough Times?

European governments have reacted to the worst Continent-wide deterioration in economic performance in several generations with a plethora of interventions. Not all of these interventions are nationality-blind, that is, some seek to overtly or covertly discriminate against foreign commercial entities or workers. Worse, as Richard Baldwin and I have recently argued (in our recent voxEU collection of such matters titled "The collapse of global trade, murky protectionism, and the crisis: Recommendations for the G20", available at www.voxeu.org), some of the very measures taken to stimulate national economies have discrimination against foreigners buried within them. Fears about such "murky protectionism" are particularly hard to dispel, as it is far less transparent than overt trade policy measures such as tariffs and quotas. Politicians find pressures to retaliate harder to resist when the mere accusation of foreign protectionism cannot be obviously and costlessly rebutted.

Resort to murky protectionism should be of great concern to anyone interested in the European project, whether they support the goals of integrating national markets or of avoiding strife among European Union members. To their credit certain European Commissioners and political leaders in member states have spoken out against growing protectionism in Europe. Still, recent developments have put advocates of European integration on the back foot, reacting defensively to a bewildering array of state initiatives. In a telling indication of the pressures involved, the European Commission relaxed its state aids rules in response to the crisis, or perhaps more accurately, in response to the realisation that it would have to take on almost all of the member states simultaneously in any balanced attempt to enforce previously agreed rules on subsidies to private firms.

These developments in Europe raise the interesting question of what can be realistically expected of binding rules on state behaviour during such crises. Even though the multilateral trading system has binding rules, because of its elaborate set of supranational institutions (including courts) Europe perhaps provides the best region in which to assess the impact of binding rules in times of economic distress. Certainly, no definitive answer to this question may be available for years. Still, it is worth reflecting on this question now as private and public sector expectations are conditioned by real or even apparent breaches of the rules.

One hard-line perspective is that a breach of the rules during this crisis foreshadows future violations and, at a minimum, difficulties in negotiating and enforcing new rules on non-discrimination in European commerce. If, so this argument might run, policymakers get into the habit of breaking EU rules then where will the process of unravelling stop? Could decades of reform efforts be undone? These are legitimate fears. Having said that, providing evidence for the proposition that political leaders in Europe have turned their back on integrated markets permanently would be difficult to muster.

There is, of course, the alternative possibility that European leaders want to have their cake and eat it. That is, they want to discriminate in the short term but, once the crisis is over, revert to being upstanding citizens that recoil from protectionism. Plus, by disavowing the more overt discriminatory tools long banned within European commerce (such as tariffs and quotas) and resorting to murkier devices instead, these political leaders may have persuaded themselves that they are not really breaking the rules. Moreover, they might misleadingly construe criticism of murky protectionism as criticism of government

intervention. Under these circumstances what can we expect from binding rules on non-discrimination?

At this point in the argument, as far as how these dynamics play out over time is concerned it is worth noting a mismatch in the time taken for the European Commission and associated courts to make decisions and the time before national policymakers come under substantial pressure to react to discriminatory "outrages" perpetrated by other governments. This is where murky protectionism is at its most insidious. Given current media technologies information about such protectionism including accusations that it might be biased against foreign commerce can be transmitted instanteously, thus putting pressure almost immediately on other governments to retaliate.

In contrast, the very fact that murky protectionism is buried inside an otherwise innocent-looking government initiative means that it will take longer for the European Commission and other neutral observers to analyse the measure. This is particularly the case when the measure taken does not explicitly state that foreign commercial entities are at a disadvantage, but where the discrimination arises upon implementation. One superficial solution might be to insist on binding rules that require pre-approval by the European Commission of a particular type of state measure. This will provide no comfort, however, when the discrimination occurs during implementation. Indeed, pre-approval clauses would provide an incentive to transform more overt protectionism into murkier, implementation-related alternatives.

Defending to the death a set of binding rules against discrimination may not be wise either, especially if in the interim many member states (in particular the largest member states) have chosen to break previously agreed commitments. Under these circumstances the defender – typically the European Commission – may trigger such an adverse reaction from the member states that the disciplines in question are not just broken but permanently removed from the rule book. However unpalatable it may seem, accepting some degree of discrimination may be prudent. A zero rate of infraction isn't the right benchmark for evaluating binding rules in times of crisis.

Even so, there may still be useful steps that the European Commission (and others charged with enforcing binding rules in other fora) could take. Even when interventions happen, securing agreement that they be time-limited and need to be reviewed before renewal would be an advance. More generally, developing "exit strategies" that allow governments to unwind any measures without much fuss would be useful.

Another innovation for future downturns might be to insist on "cooling off" periods that require that a certain period of time elapse (say 30 days) before a measure is implemented. These periods could stall retaliation if an intervening country can successfully explain to its peers that its measure is not discriminatory and has been designed in a way that its implementation is also unlikely to be discriminatory.

The purpose of this editorial has been to ask what can realistically be expected of binding rules during a sharp economic downturn. Binding rules can include non-discriminatory standards against which government measures can be usefully evaluated. Indeed, the combination of these benchmarks, transparency and peer pressure, can be particularly useful. Having said that, there are practical reasons as to why the infractions will occur and this should colour the assessment of the impact of binding rules in troubled times. Instead, steps might be taken that discourage damaging retaliation in the first place and promote the unwinding of discriminatory measures once favourable economic conditions are restored.

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